

**Statement of Karan K. Bhatia**  
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**Department of Commerce**  
**before the**  
**Subcommittee on Domestic and International Monetary Policy,**  
**Trade, and Technology**  
**of the**  
**Committee on Financial Services**  
**U.S. House of Representatives**  
**March 19, 2003**

Chairman King, Vice Chair Biggert, Congresswoman Maloney, and Members of the Subcommittee:

I appreciate the opportunity to testify today before the subcommittee on the reauthorization of the Defense Production Act, also known as the DPA. Let me start by conveying Under Secretary Juster's apologies for not being able to attend today's hearing. He had a long-standing prior commitment that required him to be out of the country today.

When this Subcommittee last convened a hearing about the importance of the DPA and its relevance in the post-Cold War era in June 2001, none of us could have then predicted the challenges that the United States would soon encounter. Nor, of course, could we have predicted the important role that DPA authorities would play in meeting those challenges.

What we did know – and what Under Secretary Juster testified to – was that for more than fifty years, the Defense Production Act has enabled the President to be able to ensure our nation's defense, civil preparedness, and military readiness. The use that has been made of DPA over the past two years – to facilitate the country's response to September 11, to strengthen the security of our homeland and our embassies abroad, and to support the deployment of troops in the Middle East – has demonstrated that it continues to be a critically important tool in meeting contemporary threats to our security. During that same period, the DPA has also facilitated important analyses of our defense industrial base, defense trade practices, and of foreign investments in U.S. companies that may pose national security issues.

Accordingly, the Commerce Department strongly supports reauthorizing the DPA for a four-year period. We also urge Congress to adopt a minor clarifying amendment to the Act that I will discuss shortly.

I will focus my comments on the DPA authorities that are relevant to the Department of Commerce and the activities of the Department under those authorities. The Department of Commerce plays several roles in implementing DPA authorities that relate to the defense industrial base. First, under Title I of the DPA, the Department administers the Defense Priorities and Allocations System. Second, under Title III, the Department reports to Congress on defense trade offsets. Third, under Title VII, the

Department analyzes the health of U.S. industrial base sectors. And fourth, also under Title VII, the Department plays a significant role in analyzing the impact of foreign investment on the national security of the United States. I will briefly discuss each of these roles.

## **I. Defense Priorities and Allocations System**

Title I of the DPA authorizes the President (i) to require the priority performance of contracts and orders necessary or appropriate to promote the national defense over other contracts or orders; (ii) to allocate materials, services, and facilities as necessary or appropriate to promote the national defense; and (iii) to require the allocation of, or the priority performance under contracts or orders relating to, supplies of materials, equipment, and services in order to assure domestic energy supplies for national defense needs. These authorities to prioritize contracts and require allocations for industrial resources are delegated to the Secretary of Commerce by Executive Order 12919.

Commerce has implemented these authorities through the Defense Priorities and Allocations System (known as "DPAS"). DPAS has two broad purposes. First, it seeks to ensure the timely availability of products, materials, and services that are needed to meet national defense and emergency preparedness requirements with minimal interference to the conduct of normal business activity. Second, it provides an operating structure to support a timely and comprehensive response by U.S. industry in the event of a national emergency.

Under the DPAS, the Department of Commerce delegates the authority to use the system to obtain critical products, materials, and services as quickly as needed by several federal agencies, including the Departments of Defense and Energy. To implement this authority, these agencies – called Delegate Agencies – place what are known as "rated orders" on essentially all procurement contracts. The prime contractors, in turn, place "rated orders" with their subcontractors for parts and components down through the vendor base. The "rated orders" notify the contractors that they are accepting contracts rated by the U.S. government. The contractors then must give these orders priority over unrated commercial orders to meet the delivery dates of the rated orders.

In the vast majority of these cases, the procuring federal agency and the contractor quickly come to mutually acceptable terms for priority production and delivery. If the company and the Delegate Agency cannot reach agreement, the Department of Commerce provides "Special Priorities Assistance" – essentially, it functions as intermediary – to resolve disputes and ensure that production bottlenecks for many military and national emergency requirements are resolved.

Let me briefly highlight a few examples of the Department's work in this important area.

Operations Desert Shield and Desert Storm. In 1990 and 1991, Commerce worked actively to administer the DPAS in support of U.S. and allied requirements for Operations Desert Shield and Desert Storm. We handled 135 Special Priorities Assistance cases to assure timely delivery of critical

items, including avionics components for aircraft, precision guided munitions, communications equipment, and protective gear for chemical weapons. In the majority of cases, due to the Commerce Department's involvement, delivery schedules were reduced from months to weeks or from weeks to days.

Coalition Action in the Balkans. From 1993 - 2000, Commerce handled 73 Special Priorities Assistance cases in support of U.S. forces, allied forces, and NATO coalition action in the Balkans. Although most of these cases pertained to NATO acquisition in the United States of communication and computer equipment, Special Priorities Assistance under DPAS also was used to expedite the production and delivery of such military items as antennas, positional beacons, and precision guided munitions for both U.S. and allied forces. Priorities authority may be used to support allied defense requirements when such support is deemed by the Department of Defense to be in the interest of U.S. national defense.

Operation Enduring Freedom. The DPAS has been used extensively to secure delivery of a number of items for both U.S. and allied forces in Operation Enduring Freedom. For the U.S. military, these items include guidance system components for "smart bomb" precision guided munitions, targeting and sensor equipment for our Predator and Global Hawk Unmanned Aerial Vehicles, and ballistic material for body armor. For our allies such as the United Kingdom, the Commerce Department has worked to obtain deliveries of such items as search and rescue radios, communication gear and helicopter equipment.

Middle East Deployment. Providing support for U.S. and allied nation forces currently deployed and deploying in the Middle East is currently a top DPAS priority for the Commerce Department. To date, we have worked closely with contractors and suppliers to achieve timely delivery to U.S. forces of urgently required items such as SATCOM radio equipment and body armor. For the United Kingdom, we have worked to achieve timely delivery of equipment vitally needed to support current U.K. deployments in the Middle East. For the Australians, we have secured timely delivery of infra-red laser targeting equipment. I should note that, in the event of military action in Iraq, we would anticipate an increase in requests for Special Priorities Assistance. We have been preparing actively for such an increase in demand, with contingency plans calling for relocating additional personnel to assist and training such personnel.

Homeland Security. In 1994, the DPA priorities and allocations authority under Title I was extended to cover civil emergency preparedness activities by the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act). This extension of authority has been relied upon to support several post-September 11 homeland security initiatives. For example:

- The Federal Bureau of Investigation was granted DPAS support for the \$380 million Trilogy Program to upgrade its communications and data processing capabilities;

- The new Transportation Security Administration was granted DPAS support to achieve the timely delivery of explosive detection systems equipment to screen checked baggage for explosives at more than 400 U.S. commercial airports. This was followed by a grant of DPAS support for TSA's 7-year, \$1 billion aviation security Information Technology Managed Services Program.
- Currently, the Commerce Department is working with the Department of Homeland Security to review a request by the Customs Service for DPAS support of its 5-year, \$1.3 billion port security Automated Commercial Environment (ACE) system.

While these examples represent only a small fraction of the total number of exercises of the DPAS, I believe they demonstrate how DPAS remains critically relevant to meeting increasingly complex contemporary national defense, emergency preparedness, and homeland security needs.

## **II. Defense Trade Offsets**

Pursuant to Section 309 of the DPA, the Department of Commerce reports to the Congress on the use of offsets in defense trade. Offsets are industrial compensation practices required by foreign governments as a condition of purchase of defense articles and/or services. For example, a foreign government may agree to purchase fighter aircraft from an American manufacturer, but can require that some of the aircraft components be produced in the foreign country using local suppliers. Foreign governments may also demand technology transfer, local investment, and countertrade as part of the agreement.

In February of this year, Commerce sent its sixth report on offsets to Congress covering the period 1993 through 1999. From the anecdotal reports we have received, the report appears to have been widely read and well-received by Congress and by industry. The report found that, during the covered time period, U.S. defense exports were increasingly affected by the use of offsets as part of defense sales, especially in light of a global retrenchment in military expenditures. Specifically, we found that offsets have become an increasingly important factor in determining contract awards, and have a direct bearing on U.S. defense contractors' access to foreign markets. Offset agreements in excess of 100 percent of the contract value are occurring with increasing frequency, and in some cases have exceeded 300 percent of the contract.

As a matter of policy, the U.S. Government is not involved in the development of offset proposals by U.S. defense firms as they bid on international defense weapons projects. However, as the report expresses, the Department of Commerce is concerned that the level of offsets required by foreign governments appears to be rising and that the offset package is becoming a signal factor in determining a contract award. In the event that U.S. defense firms are prevented from competing on a level playing field in the international marketplace, the U.S. industrial base at both the prime and the subcontractor levels will suffer. Accordingly, the Department of Commerce is committed to working with U.S.

industry, the Department of Defense, and foreign governments to analyze the impact of offsets on all parties and to seek ways to mitigate the adverse effects of offsets on competition.

### **III. Defense Industrial Base Studies**

Under Section 705 of the DPA and Executive Order 12656, the Department of Commerce conducts surveys and analyses, and prepares reports on specific sectors of the U.S. defense industrial base. These studies are usually requested by the Armed Services, Congress, or industry. Using these industrial base studies, the Departments of Commerce and Defense can, for example, measure industry capabilities in an area such as high-performance explosives or measure industry dependence on foreign materials in manufacturing U.S. defense systems. The studies provide a competitive benchmark of critical sectors within the U.S. defense industrial base and gauge the capabilities of these sectors to provide defense items to the U.S. military. The studies also provide detailed data that are unavailable from other sources.

Currently, the Department of Commerce has a number of studies underway, including assessments of the Air Delivery (Parachute) Industry, the Munitions Power Sources (Batteries) Industry, and Shipbuilder's Subcontractor Base. When completed, these assessments will provide the Department of Defense with information needed to understand the health and viability of each sector.

The current Section 705 of the DPA provides the Department of Commerce investigative authority regarding the defense industrial base. However, Section 705 does not reference studies conducted under Executive Order 12656 which specifically authorizes the Secretary of Commerce to conduct industrial base assessments to support the national defense under the DPA. Commerce would support a change to Section 705 that makes clear the linkage between DPA Section 705 and Executive Order 12656.

### **IV. Foreign Investments in the United States**

Finally, Commerce is involved in the exercise of authority under Section 721 of the DPA, known as the "Exon-Florio provision" (which unlike the other provisions described above, would not expire without reauthorization, but I describe for the sake of completeness). Section 721 authorizes the President to prohibit foreign investments in U.S. companies when there is credible evidence that it will result in foreign control of the U.S. business and the foreign interest exercising the control "might take action that threatens to impair the national security." Pursuant to Executive Order 12661, the President has designated an interagency Committee on Foreign Investment in the United States ("CFIUS") to assist in the exercise of this authority. The Department of Commerce's contribution to the CFIUS process includes providing a defense industrial base and export control perspective to the CFIUS reviews. While the United States remains generally very much open to foreign investment – and the Exon-Florio authority has been used quite rarely – in this period of rapid globalization, the existence of this authority and the interagency review process are important.

## **Summary**

In sum, the DPA provides authority for a variety of programs at the Department of Commerce of substantial importance to our nation's security. Through DPAS, it facilitates the timely and effective provision of necessary supplies to our military, to our close allies, and increasingly, to meet Homeland Security requirements. The DPA also facilitates valuable assessments of the impact of offsets in defense trade and the health of key sectors of the defense industrial base. Finally, it affords the U.S. Government the opportunity to assess – and if necessary, take steps to limit – foreign investments in U.S. companies that could threaten U.S. national security.

Most provisions of the Defense Production Act are not permanent law and must be renewed by Congress. For all these reasons, the Department of Commerce fully supports extending the Defense Production Act for a four-year period.

Thank you.